

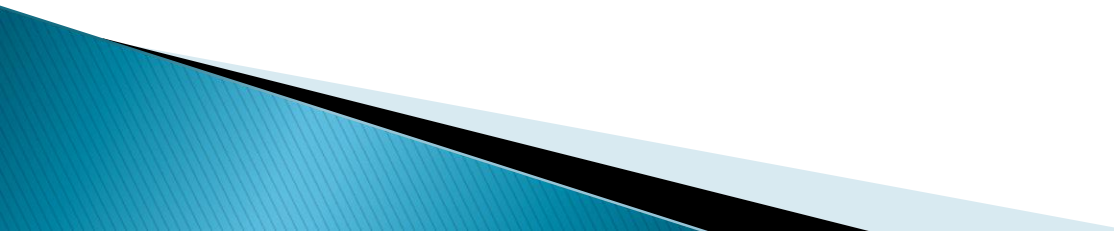
Using HUD Multifamily Housing Programs in Mixed-Finance Transactions

Jim Provenzale

Associate Regional Counsel for Housing Finance and Programs

James.V.ProvenzaleIII@hud.gov

Agenda

- ▶ Background information on HUD multifamily housing programs
 - ▶ Modifications to HUD programs geared towards the tax credit industry
 - ▶ Mixed-Finance Success Story
- 

Background on HUD Multifamily Programs

- ▶ Most HUD multifamily housing finance programs fall into one of two categories:
 - FHA-insured Mortgages
 - Capital Advance Mortgages

FHA Insurance

- ▶ FHA insurance protects lenders against the risk of the borrowers defaulting on loans
- ▶ Extraordinary surge of interest in FHA multifamily loan insurance over the past three years

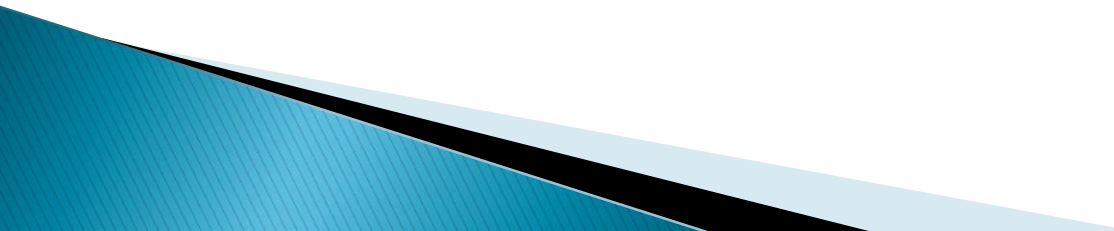
FHA Insurance, cont.

- ▶ The Section 221(d)(4) Mortgage
 - For new construction and substantial rehabilitation
 - Construction and permanent financing, wrapped into a single mortgage
 - Maximum mortgage amount = 90% of HUD's replacement cost estimate
 - Maximum mortgage term = 40 years

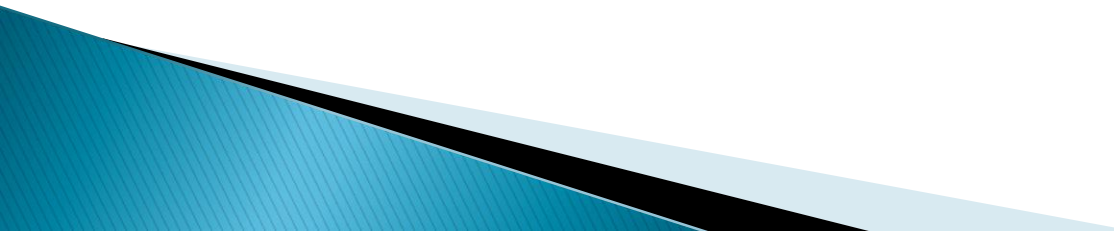
FHA Insurance, cont.

- ▶ Additional advantages of the “(d)(4)” mortgage (applicable to all FHA-insured financing):
 - Non-recourse loans (personal assets of the principals of the borrower are generally safe)
 - Fully assumable – this can be especially valuable in an era of historically low interest rates

Capital Advance Programs

- ▶ Money flows directly from HUD to the project owner
 - ▶ Residents in capital advance projects must be very low-income elderly (the Section 202 program) or very low-income persons with disabilities (the Section 811 program)
 - ▶ Like LIHTCs, you must compete for capital advance funds
 - ▶ Capital advance paired with PRAC
- 

2530 Clearance and the PAPI Act of 2007

- ▶ The 2530 process is HUD's method of ensuring that people and entities who want to participate in the agency's programs have an acceptable history of previous HUD participation.
 - ▶ The drawback: filling out form HUD-2530 can be time-consuming
- 

2530 Clearance and the PAPI Act of 2007

- ▶ Preservation Approval Process Improvement Act of 2007 – two primary functions:
 - Electronic filing of 2530 no longer required
 - LIHTC investors need not file 2530

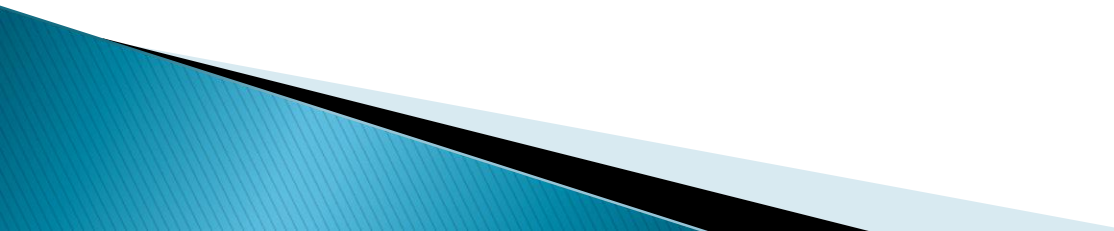
HERA's Impact on Mixed-Financing

- ▶ Housing and Economic Recovery Act of 2008 (HERA) – changed the relationship between LIHTCs and HUD multifamily programs in three key areas:
 - Subsidy layering
 - Cost certification
 - Tax credit equity escrow requirement

HERA's Impact on Mixed-Financing, cont.

- ▶ Subsidy layering – a means of preventing the duplication of governmental assistance
- ▶ HUD subsidy + another form of governmental financial assistance = subsidy layering review

HERA's Impact on Mixed-Financing, cont.

- ▶ Pre-HERA – HUD multifamily mortgage insurance was a HUD subsidy
 - ▶ Post-HERA – mortgage insurance no longer considered a HUD subsidy
 - ▶ Accordingly, combining FHA-insurance and tax credits does not necessitate a subsidy layering review, so long as no other type of HUD subsidy is involved
- 

HERA's Impact on Mixed-Financing, cont.

- ▶ Cost certification – a means of determining whether the final mortgage is in the correct amount
 - Pre-HERA – all owners with HUD-insured NC/SR loans had to cost certify at project completion
 - Post-HERA – if the deal involves LIHTCs, and the loan-to-value ratio is less than 80%, no cost certification required

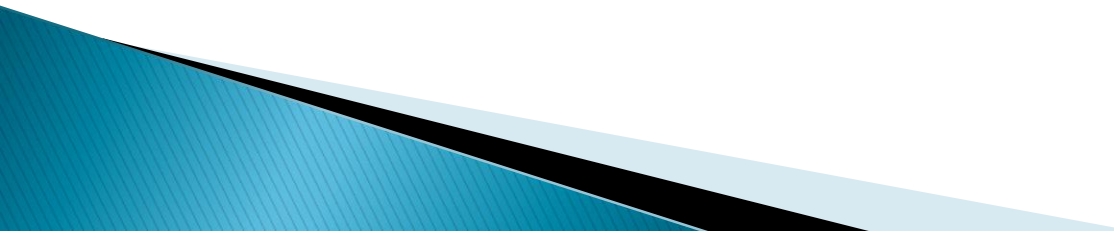
HERA's Impact on Mixed-Financing, cont.

- ▶ Tax credit equity and HUD's escrow requirement
 - Pre-HERA 24 CFR Section 200.54: “. . . the mortgagor shall deposit with the mortgagee cash sufficient, when added to the proceeds of the insured mortgage, to assure completion of the project”
 - Practical effect: owners of LIHTC projects had to get bridge loans at start of construction

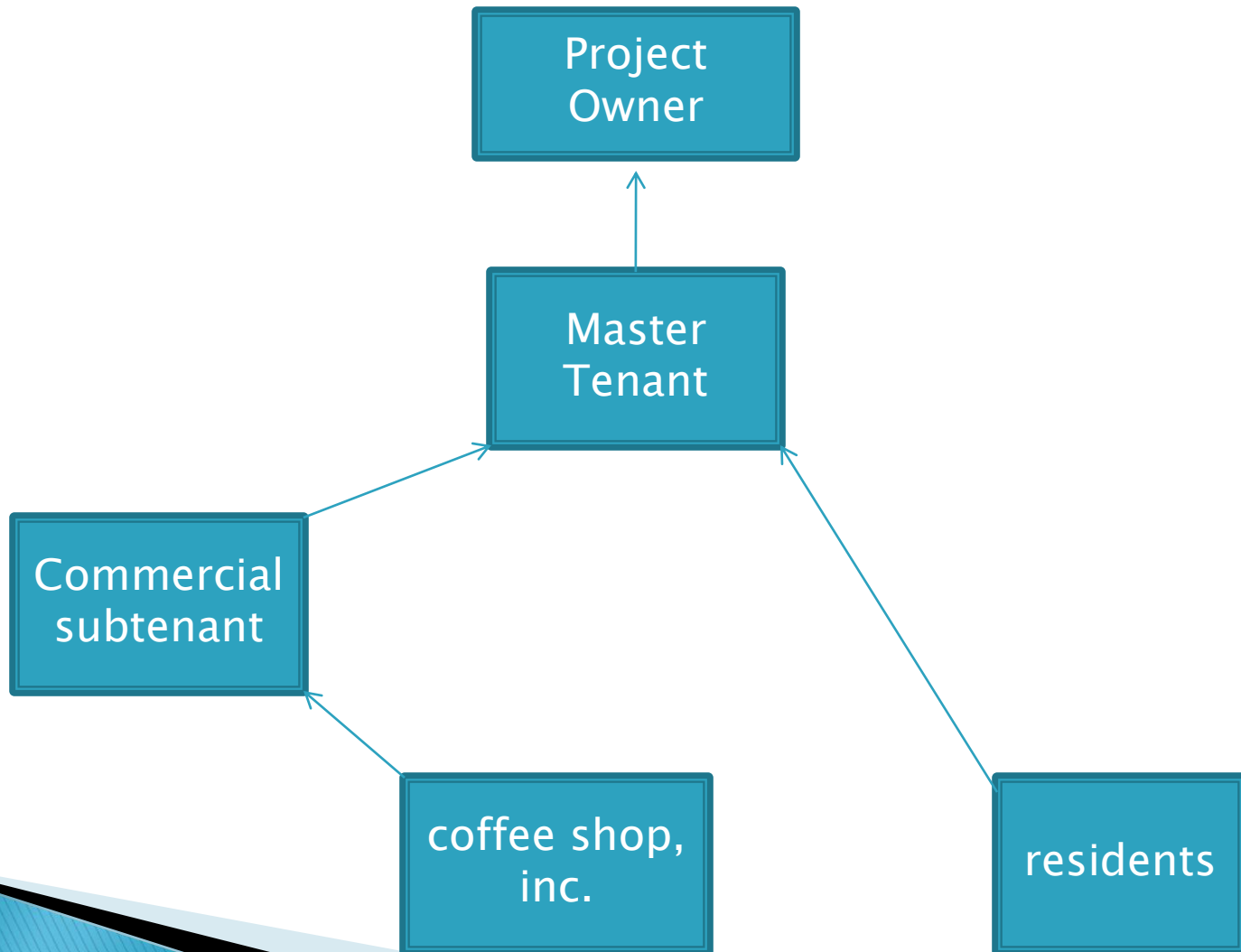
HERA's Impact on Mixed-Financing, cont.

- ▶ Post-HERA – HUD can't require the owner to escrow any tax credit equity as a condition of getting a HUD-insured mortgage
 - This applies to all types of tax credits
 - Owner needs to spend 20% of the total tax credit equity at the time the HUD-insured funds start to flow

Master Leases

- ▶ HUD articulated its Master Lease policy in Mortgagee Letter 09-40
 - ▶ Represents another attempt to tailor HUD multifamily programs to the needs of tax credit projects
- 

Master Leases, cont.



Master Lease, cont.

- ▶ Mortgagee Letter 09-40 – HUD's requirements for Master Lease deals include the following:
 - Master Tenant and all sublessees (except the end users) must be single-asset, single-purpose entities
 - Master Tenant and all sublessees (except the end users) must sign HUD Regulatory Agreements
 - Master Lease and subleases must state that HUD can direct the Master Tenant and/or sublessees to make payments directly to the mortgagee if there's a default under the FHA documents

The Modernized Section 811 Program

- ▶ Frank Melville Supportive Housing Investment Act of 2010
 - Aims to promote “integrated” housing (disabled and non-disabled populations living side-by-side under one roof)
 - Increased focus on creating state–federal partnerships in the creation of affordable housing for persons with disabilities

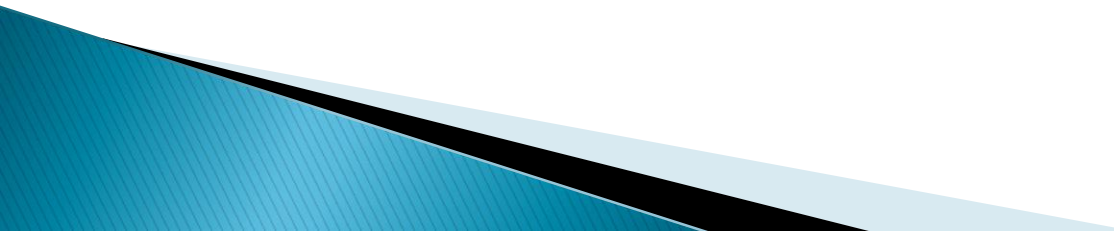
The Modernized Section 811 Program, cont.

- ▶ The initial PRAC term
 - Old statute – every 811 project owner got the same initial term
 - Frank Melville – state-assisted projects get a 30 year initial PRAC term (as opposed to 3 or 5 years for conventional 811s)

The Modernized Section 811 Program, cont.

- ▶ Minimum allocation of 811 dollars
 - “The Secretary shall establish a minimum percentage of the amount made available for each fiscal year for capital advance . . . that shall be used for [Section 811 mixed-finance projects].”

The Modernized Section 811 Program, cont.

- ▶ Delegated Underwriting
 - Old 811 program – Section 811 state–assisted mixed–finance projects had two agencies actively participating in the underwriting process: HUD and the state housing finance agency
 - New 811 program – when HUD makes an award of 811 funds to a mixed–finance project, HUD must delegate underwriting responsibilities
- 

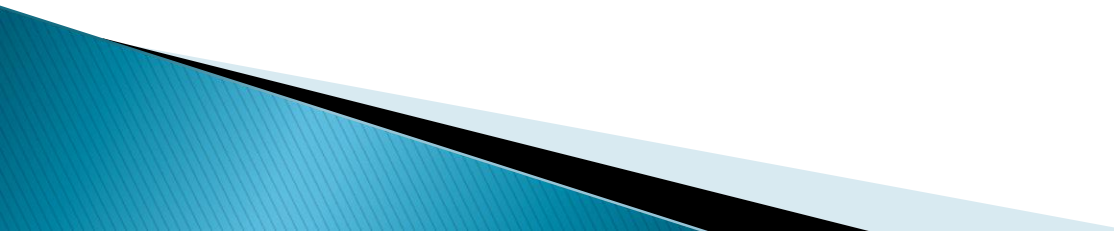
The Modernized Section 811 Program, cont.

- ▶ The PRAC Demonstration Program
 - The capital advance and PRAC need not come as a pair anymore
 - Owners may qualify for just the PRAC if the following apply:
 - Project serves the extremely low-income disabled
 - Project receives some form of governmental funding
 - State agency responsible for Medicaid provides appropriate services for the project

Grand Boulevard Lofts – KCMO



Grand Boulevard Lofts – KCMO, cont.

- ▶ 2009 – the building at 1006 Grand Blvd. in downtown Kansas City, Missouri had sat vacant for roughly two decades
 - ▶ Urban redevelopment in the blocks surrounding the building had been flourishing since 2007
- 

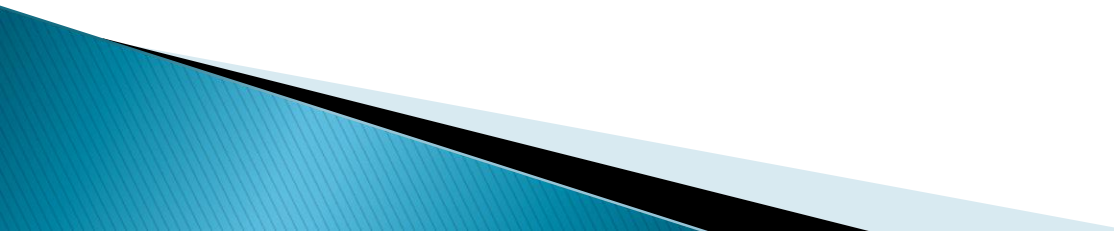
Grand Boulevard Lofts – KCMO, cont.



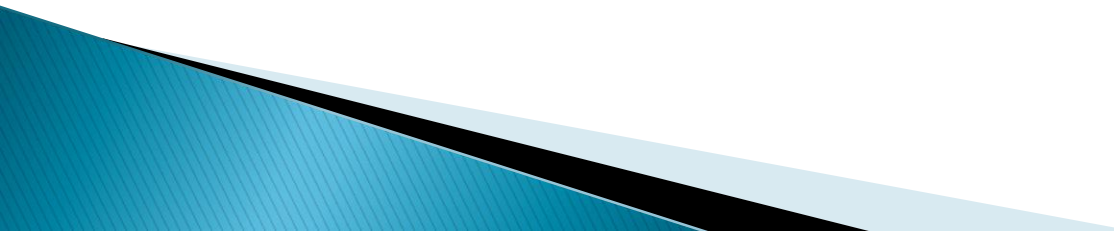
Grand Boulevard Lofts – KCMO, cont.



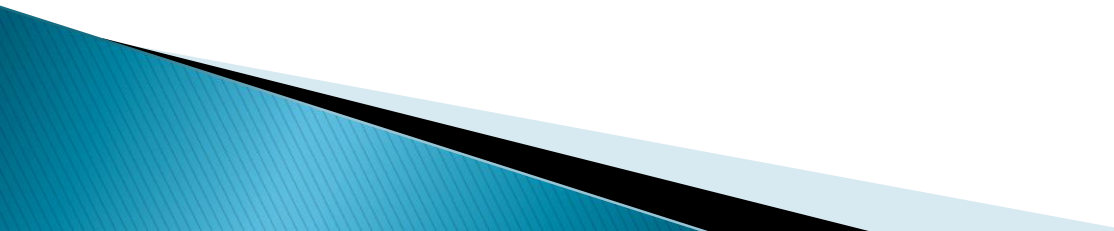
Grand Boulevard Lofts – KCMO, cont.

- ▶ The developer's \$30,000,000 financing plan – purchase and rehabilitate the building with the following sources of assistance:
 - 4% LIHTCs
 - Tax-exempt bond financing
 - Tax abatement
 - CDBG funds
 - Soft second mortgage from MHDC (TCAP funds)
 - \$9,000,000 221(d)(4) mortgage
- 

Grand Boulevard Lofts – KCMO, cont.

- ▶ The acquisition credit
 - An owner can't qualify for an acquisition credit if the building being acquired has been placed in service at any point during the 10 years prior to the acquisition.
 - Problem – ground floor commercial space had been placed in service at some point between 2000 and 2005 (pizza shop)
- 

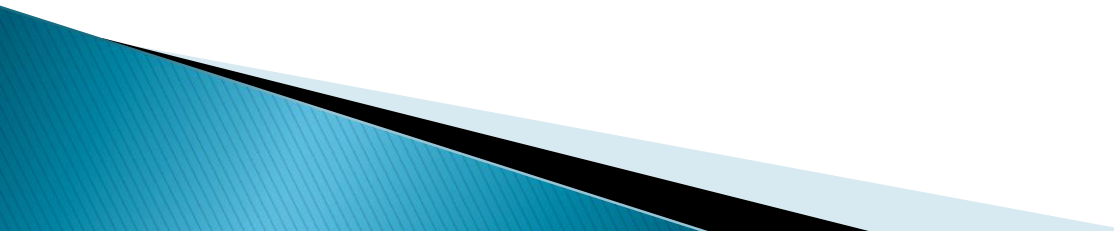
Grand Boulevard Lofts – KCMO, cont.

- ▶ The developer's first proposed solution: mortgagor would acquire only floors 2 through 17
 - ▶ HUD's response: "The underwriting for the HUD-insured mortgage was based on the value of the whole building, not just floors 2 through 17."
- 

Grand Boulevard Lofts – KCMO, cont.

- ▶ The developer's second proposed solution:
utilize a master lease
 - Master tenant would be the “owner” of the ground floor space (for tax purposes)
- ▶ HUD's response: “OK, we can get behind this.”

Grand Boulevard Lofts – KCMO, cont.

- ▶ Developer's tax lawyers: "Master Tenant must be able to install commercial subtenants without having to seek approval of the lender or HUD."
 - ▶ HUD's response: "That would violate the HUD Regulatory Agreement."
- 

Grand Boulevard Lofts – KCMO, cont.

- ▶ The compromise: HUD and the developer agreed on a list of pre-approved categories of commercial use for the ground floor